

DOW THEORY LETTERS INC.

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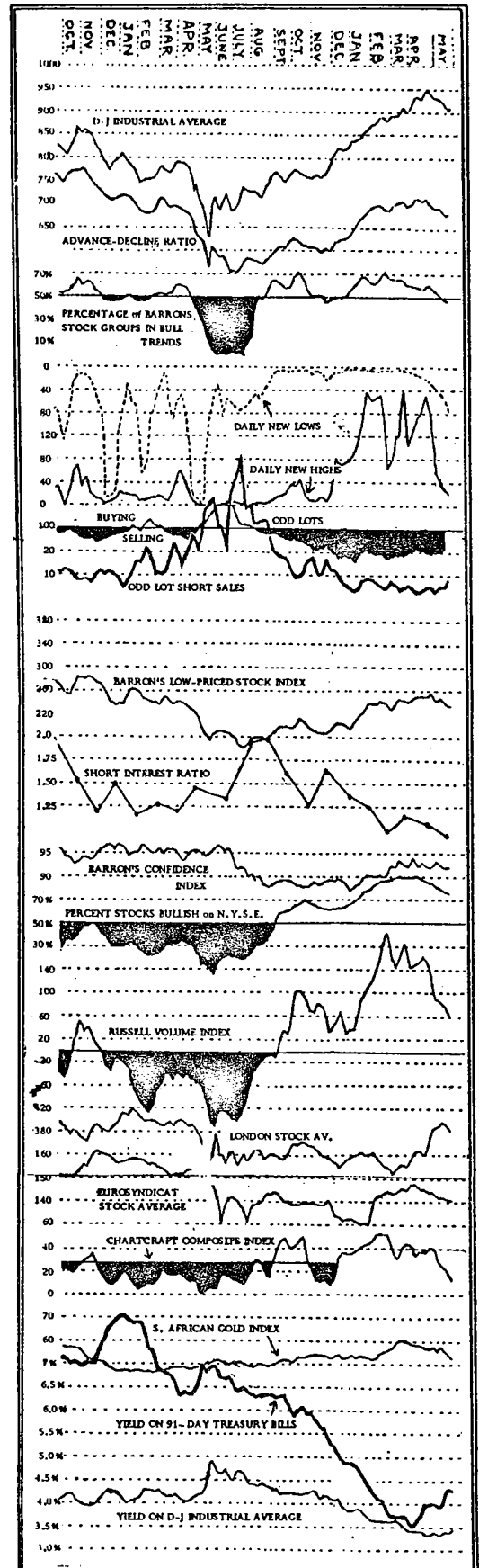
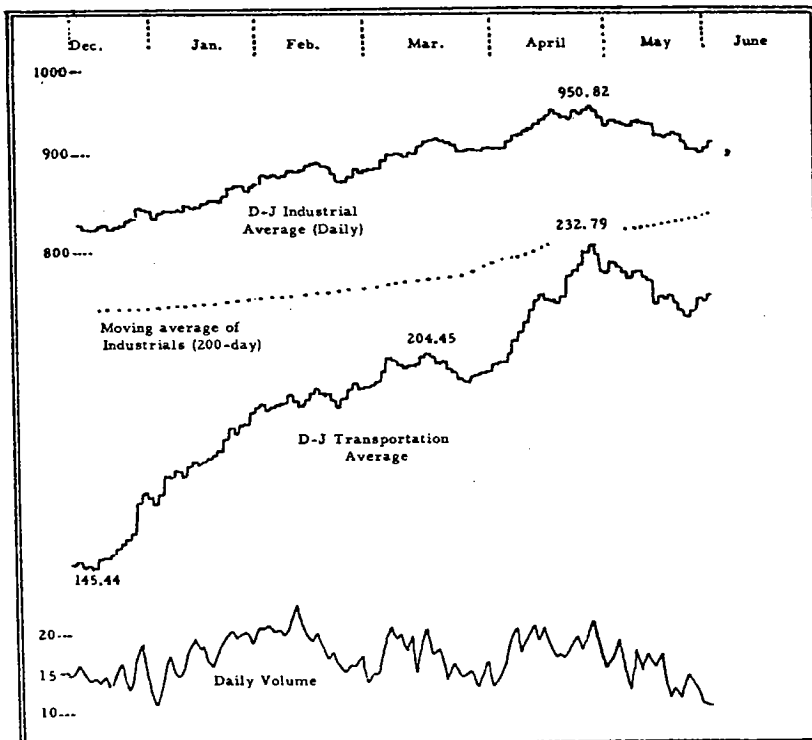
June 4, 1971

Letter 497

STRANGE PICTURE: A few weeks away from my typewriter has provided me with a different perspective and a good many new thoughts. One thought that occurred to me (forcibly thrust upon me, is more like it) is that it is almost impossible to keep up with the sheer, massive, insane, avalanche of data, figures, statistics, indices and indicators which are now emanating from Wall Street. It is as though analysis (technical analysis, monetary analysis, economic analysis) has suddenly erupted and spewn its lava of facts, pseudo-facts and figures over the land in a fireworks display which defies rationality or intelligent comprehension.

Almost weekly, a "new important market indicator" such as the "option activity" index or the "every skip-a-day" index or the "normalized up-down volume" index emerges. Often a whole new investment service is instituted, based on the "invention" of a new index or two which, "when taken back retroactively to 1932, has shown incredibly superior results."

Frankly, my reaction to what is happening on the "endless indicator front" is quite the opposite of what it used to be. Back in the mid-1950's or even in the early 1960's I was apt to become quite excited by the publication of a new stock market index which appeared "to work". I think my enthusiasm began to pall about the time that the N.Y.S.E. and many others came out with their own, "authentic" stock averages. From then on, I found my interest in new indices and devices mingled with both enthusiasm (although decreasing enthusiasm) and anxiety. This year, with the emphasis centered wildly on the money supply, my mixed enthusiasm and anxiety has definitely turned to total dismay plus a feeling of madness. In a phrase, I believe the investment world is sinking into a mire of indicators which is so intricate, so complex, so



Therefore, it is no coincidence that I find myself turning more and more to the time-honored studies which have worked, which have withstood the test of the years. First and foremost of these, of course, is the study of the action of the Averages themselves. The fact is that (aside from individual stock studies) 90% of all that goes on in Wall Street analysis is aimed at figuring "which way" the Averages (i. e., the market) is heading. That body of knowledge based on a reading of the Averages themselves (as readers have no doubt guessed) is all part of classic Dow Theory.

But aside from Dow Theory, I find myself turning increasingly to the things I used to read three, four and five years ago. Economic reports like the one written by Eliot Janeway, stock market reports like the ones put out by people like E. George Schaefer and Paul Dysart, reports which have proved themselves over the years, authored by men who have kept their perspective throughout decades of change.

One of the shocks which I received early in my business career occurred when I perused the pages of Barron's during the years 1942 and 1949 (both bear market bottom years). The amount of investment advisory advertising which appeared in Barron's during those days was shockingly small, often only a few ads in each issue. Where were all the bright boys and the brilliant, flashing indicators during 1942 and 1949? Where were the services which, if they existed then, could correctly have put their subscribers into stocks at the bargain rates of the century? Ironically, when the great stock buys were around, the services weren't around to tell anybody about it.

Now, the cycle has reversed. I imagine there are literally more investment services available today than there are good stocks to buy. The cycle has run its course, and today's "investor" is overwhelmed with information on every conceivable aspect of Wall Street. Yet, strangely, the confusion seems to actually grow with the number of services offered.

THE MARKET: The 1970-71 bear market rally has produced some of the most extraordinary distortions in indicator relationships in stock market history. For instance, while the market was climbing through most of 1971, the bond market was falling. On the week ending May 21 the spread between the yield on Barron's High-Grade Bonds and the yield on the Dow Industrials hit 4.11%, biggest spread in 13 years. With this kind of yield spread in favor of bonds, writes E. Schonberger of the L.A. Times, the Dow would have to rise to 1500 over the next decade for an investor to receive a return comparable to those available in bonds today.

The profile of the Dow Industrial and Transportation Averages are not particularly interesting or illuminating at this time. Bulls can argue that we are in a healthy reaction phase preparatory to new highs, while bears can say that the perpendicular "spike" formations of these two Averages have now terminated in the usual spearpoint tops. The really interesting Average, however, is the Utility Average which has been in a downtrend for the past four months, and is now back in the territory, which (until 1968-70) had not been seen since 1962. Daily, and with rather ominous implications (since Utilities have so often led the main direction of the market) we are seeing new 1971 lows on the Utility Average. I can hardly see how anyone can construe this action of the "third Average" as being anything but bearish.

Barron's stock/bond ratio (covered in many previous issues) is still at an absurd 1.23, compared to a peak of 1.09 in 1929 and 1.14 in late-1968. In other words, bond yield in relation to the price/earnings ratios on stocks were never more attractive and stocks were never more overpriced in connection with bonds.

It all might make some sort of sense if perpetual inflation and perpetual earnings rises were in the bag. But within the context of the current primary bear market, the precarious position of the dollar, the tidal wave of vicious and relentless foreign competition and the specter of possible powerful trade blocks being formed against the U.S., the current price of equities as compared with the price of bonds makes this market unbelievably dangerous. In fact, I feel that as, and if, an awareness of the facts emerges, this stock market could easily collapse in a panic of almost torrential proportions.

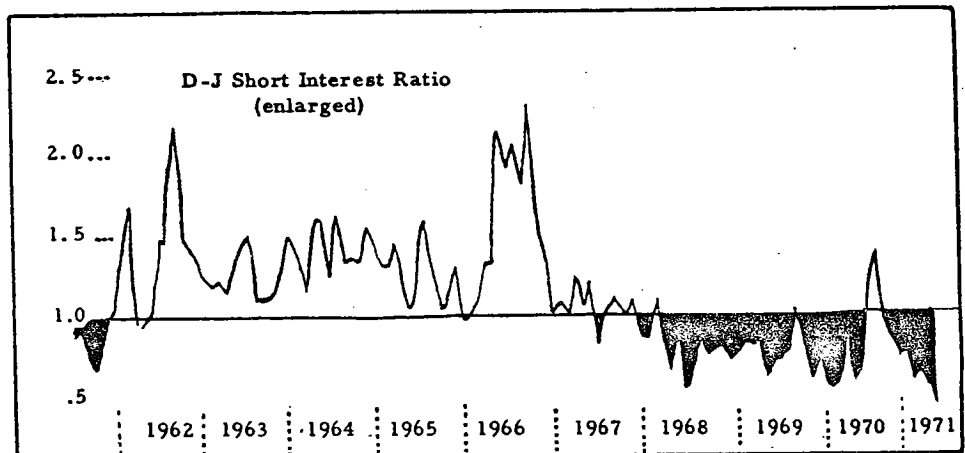
Another index which is fairly screaming to be scrutinized is the Dow short interest ratio (see next section) which has now dropped to a low level which very probably will never be seen again by the current generation. Couple this with the very low level of odd-lot shorting as this market backs off from its 1971 highs, and we get a situation which is positively breathtaking in its implications. True, the stock market has been "holding its breath" for five years now as this primary bear market builds and develops its edifice of disaster, but the base of the tower is made of sand, and the bear tide is washing the sand away, cup-full by cup-full, bucket by bucket.

One rather fascinating segment of the current market picture is that the mutual funds' cash ratio has now dropped to 5.5%, a level considered near "rock-bottom". With little cash coming in from the public via purchases over redemptions, this leaves the market rather precariously perched at the "greater fool level". That is the level at which the funds reckon that the public "should come in and buy". But so far, the funds have been dreadfully wrong. The little man, the odd-lotter, the man in the street, has shown little inclination to take the shares off the funds' hands or for that matter to buy much at all.

Perhaps the odd-lotter is really the same guy who lives in Grand Rapids or Brooklyn and who knows that its getting tougher to get a job and that his neighbor has just been laid off while the guy down the street hasn't received any overtime in a year. He is also getting sick of paying more for food every time he goes to the supermarket, and big cars no longer interest him. What interests him now is simply "making it", and the way things are going, he's just about doing that.

So the politicians talk and the Administration delivers the "big hype" and the little guy looks at his own bank account and his monthly bills and wonders. And that, it seems to me, is the way its going in the nation, and the way it "feels" right now on Wall Street. Meanwhile, the funds hold the stocks, and an increasing number of fund holders want to hold a little cold, hard cash. Either they want to hold it — or they just plain need it.

DOW SHORT INTEREST RATIO: It is now well known through the chasms of Wall Street that the short interest ratio on the N.Y.S.E. fell last month to .97, lowest level since 1962. Readers of these reports know that although I was one of the writers who originally popularized the short interest ratio (see "Tell-Tale Ratio", Barron's, December 28, 1959), I now give much more credence to the short interest ratio in the 30 Dow Industrial stocks. This is the ratio worked out by Bill Gordon of New York, and as far as I know Dow Theory Letters is the only investment service which carries statistics and analyses of this ratio.



Last week I received a letter from Bill Gordon stating that the actual Dow short interest fell from the 637,700 figure of April to 565,000 shares short (in the 30 Dow stocks) in May. With higher volume during the May period, the Dow short interest ratio dropped from a very low reading of .53 in April to an incredible .42 in May.

Now this .42 figure (see chart) is the lowest figure in "modern history", and the only lower one on the record is the .37 figure of July, 1933. I consider the current .42 figure highly dangerous, and I consider that the Dow short interest ratio is issuing its strongest bearish warning in history. The Dow short interest ratio (see previous studies) has a long history going back to 1931. It has been very good at denoting "top areas" or areas which are outstandingly dangerous for holders of stocks. The current reading is unequivocal in its warning level. Let the buyer and holder beware.

THE PICTURE: Slowly but irresistably, the writing appears on the wall. The forces of American inflation have collided head on with Germany and German big business. Decades of American sloppy thinking and hypocrisy have come to an end, and Europe is no longer willing to absorb America's "paper money", paper money issued so that U.S. politicians can keep the domestic economy afloat. "Afloat" is the word for it. For in the face of every business recession since 1957, the U.S. has seen fit to float itself back into a state of "prosperity" via a huge boost in the money supply, manipulation downward of the interest rates, plus a barrage of Government propaganda as the Dow Industrials pushed upward toward new highs.

As far as the Dow is concerned, it all ended in February, 1966, as the last of the great "new highs" was seen. Since then, despite the same inflationary tactics, the same flood of dollars, the same manipulation of interest rates, the Dow has been unable to better its 1966 bull market high of 995.15.

What had happened? A primary bear market had begun in February, 1966, and despite every fiscal and monetary trick in the U.S. political book, the forces of the bear market were saying that the dream had been punctured (punctured, mind you, not collapsed).

Monetary crisis after crisis occurred following the 1966 bull market top, and each time a U.S. administration played Humpty Dumpty by putting business together again.

Then along came the 1969-70 stock market collapse and simultaneously, interest rates soared to their highest level since the Civil War. Anxiety, disbelief, then panic overtook Washington. President Nixon, the man who had said that inflation was one of the greatest dangers of our times, declared himself a Keynesian. And the printing presses turned on again as America sought

There was something different about this crisis, however. Although the Americans treated the entire affair with "benign neglect", Europe, after years of fiscal cowardice, finally raised a mailed fist.

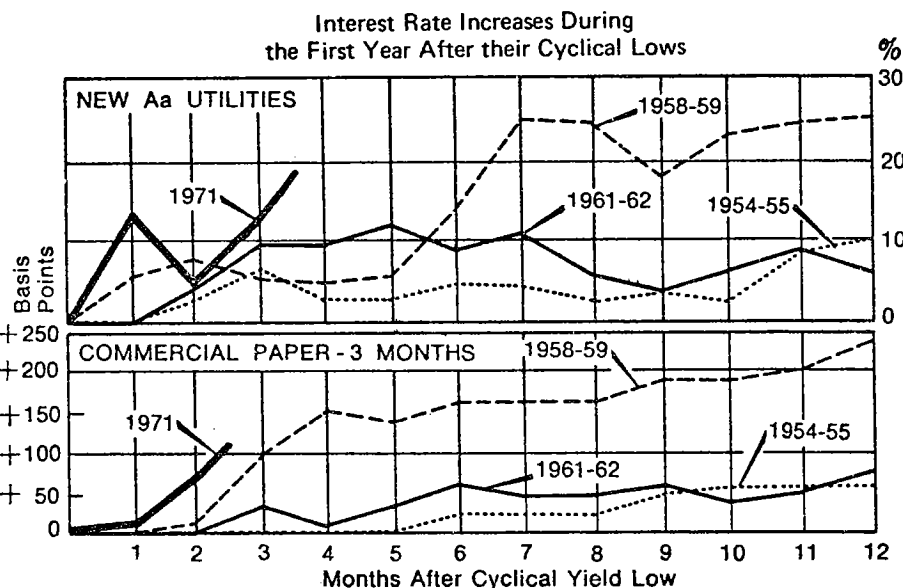
With forty to fifty billion dollars of foreign claims on U.S. reserves, the pressure was on. As late as May 26, 1971, U.S. gold reserves dropped (in their sixth consecutive monthly decline) to \$10.3 billion. On top of this, it was announced on May 27 that the U.S. has suffered its first actual trade deficit in over three years.

The record trade deficit was underlined by the biggest monthly accumulation of imports in U.S. history. Even while Europe was chafing under the bit of American stupidity and arrogance, news of wage increase after wage increase and price increase after price increase appeared in daily newspaper headlines. In California, bellwether state of the auto industry, one-third of all the new cars now being sold are imports. This figure alone should serve to underline the severity of the crisis.

The fact is that the American international trade situation is horrendous and continues to deteriorate. Just as depressing, however, is the utter arrogance of America's leaders in thinking that they can refloat our economy on another ocean of fiat dollars. A few weeks ago, Germany, the strongest economic power in Europe, finally took its economic stand. It floated the mark, thereby allowing the strength of the German mark as against the weakness of the American dollar to be seen by all.

On May 25 Otmar Emminger, deputy governor of the Bundesbank, hinted that the mark may be allowed to float for many months (rather than the few weeks expected), and tensions between the U.S. and Germany mounted further. Mr. Emminger announced that three conditions would be necessary before the old mark-dollar parity could be re-established. First, the U.S. must return to being an island of stability. Second, the U.S. must have a better basic balance in its international payments, and, third, (listen to this) that U.S. interest rates must be allowed to rise while European interest rates decline to meet them. In other words, Germany, as spokesman for the Common Market, was finally laying it on the line!

Perhaps the money markets, in their mysterious, all-knowing way, have already read into the European mind. Note the accompanying chart (from the Salomon Bros., May 21 report) and its heavy black lines denoting interest rates during 1971 for both Aa Utilities and commercial paper. In each case the 1971 interest rates have jumped well above prior interest rates (measuring from the cyclical low points of previous recessions). Salomon Bros. calls this "an early warning". They note that all the economic recoveries since World War II were characterized by slow, modest increases in interest rates. The single exception was 1958 when a sharp rise in interest rates was accompanied by a very short improvement in business, followed quickly by another recession. This, is what I believe we have in store for us now.



On May 27 the International Banking Conference in Munich suggested a world-wide overhaul of the monetary system. The announcement seemed innocent enough but the implications were hardly innocent. The times have changed and now for the first time Europe will be calling the shots. America, arrogant to the last, will finally be facing the fact that when a man with \$10 billion in real assets faces creditors with \$50 billion in IOU's, pride becomes an idiotic, really pathetic pose.

The whole drama unfolded further when, on May 28 (in Munich) Treasury Secretary Connally loaded the tired old "blackmail gun" again, and warned European bankers that unless the U.S. received help in its hour of financial need, the U.S. would be unprepared to continue carrying the burden of policing the free world. A few weeks earlier Senator Mansfield had opted for pulling half our troops out of Germany, but that thought was dispatched as an idea akin to free world suicide.

At Munich Mr. Connally chided the Germans for floating the mark at all. How dare they, he asked, resort to monetary methods and exchange controls, and how dare they question the policies of a U.S. Administration which was merely doing what was necessary to refloat its battered economy back to a state of pre-election opulence. During the same Munich meeting Federal Reserve Chairman Arthur Burns again called for price and wage controls as the only alternative to endless U.S. inflation. What

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Mr. Burns means, of course, is that with wage and price controls (assuming they work to stop inflation) interest rates can be held or even lowered in the U.S.

So on it goes, the grim drama, the confrontations, the rising strength of Europe and the Common Market, the increasing resistance of Europe to America's exported inflation, the high pressure tactics of American politicians, and the shadow of new rules, regulations, exchange controls, laws, and restrictions as the U.S. attempts to self-inflate itself again like a giant, overstrained balloon.

The whole tragedy falls within the framework which I have so often talked about and warned about, the primary bear market which started in 1966 following the greatest bull market of all time. Five years have passed since 1966, and the forces of the Administration have been in a ceaseless battle with the forces of the bear.

To me, the writing is, and always has been on the wall. This primary bear market has been held off by tactics and methods which would have seemed unbelievable a decade ago. Europe, cowardly and totally dependent on the U.S. dollar and U.S. military might, had abdicated its right to do anything but absorb dollars and complain.

Now, however, change has occurred as Charles H. Dow promised it always would. The one thing you can count on, said Dow at the turn of the century, is the inevitability of change. I feel that slowly but surely, as the U.S. faces the vicious competition of the Common Market on one side and a fantastically competitive Japan on the other, a gathering economic storm will develop. That storm will turn into a depression, but that may not be felt until perhaps 1972. But before this bear market is over, the world will be engulfed in one of the worst speculative collapses and economic fiascos of the century.

The plot thickens almost weekly, but few see the forest for the trees. Perhaps the easiest of the omens to read has been the collapse of the mighty Penn-Central. It would not surprise me now to see Lockheed or King Resources (possibly both) go to the wall. Others will follow as the culmination of an era of greed and avarice comes to its inevitable conclusion.

I am including this excerpt (on page 6) from Human Events (May 22), a piece by advertising genius Jerry Della Fama, regarding his experiences making commercials in Japan. I found this piece worth a whole book on why the American economic system is sinking steadily into deeper trouble. Frankly, I was never one who exhorted the value of work alone as a purgative for the human soul. But if you are going to be in business and make a profit, then you have got to compete and you cannot compete when your company is spending 50% of its energy and funds on nonsense. The Japanese know this, and they are moving ahead at a rate which is frightening U.S. businessmen. Read this little article, and you will understand why, and you will know what the U.S. is up against. Sooner or later, greed and immorality must give way to reason and reality. That's what the primary bear market is all about, and that is where the world is now. And those are some of the thoughts that have occurred to me over the last few weeks.

UTILITIES: I am including on page 6 a chart of the D-J Utility Average (monthly range). Note that it was the Utilities that turned down first in 1966 (prior to the 1966 cave-in), and again in late -1968 it was the Utilities which showed the real weakness (barely bettering their 1965 and 1967 tops) prior to the massive 1969-70 collapse.

Again, today it is the Utility Average which is showing outstanding and ominous weakness, hitting new 1971 lows almost daily. Note on the chart that the Utility Average is now well below the lows of 1966 and 1967-68. I consider the Utility action as an early warning sign. (Utility chart courtesy of M.C. Horsey Co.).

By JERRY DELLA FEMINA in *Marketing/Communications*

It was going to be a nightmare. We were going to shoot three commercials for Fuji Film in Japan and everything I hate about shooting a commercial in the United States where I can understand the language went double for Japan.

After a bumpy 18-hour flight my plane landed in Tokyo Airport. I immediately went into the phone booth, threw an American dime in the pay phone and couldn't for the life of me understand why I didn't get an American dial tone. Bad start.

Met the Japanese crew at the Hotel Okura and asked Bob Giraldi and Dick Raboy, who had flown in a week earlier, what it was like to work with the Japanese. They both gave me an inscrutable smile and said you'll never believe it. I was afraid to ask what they meant by that.

In the next five days I found out. It was wonderful. It was tremendous. It was sensational. You'll never know how delightful it is to shoot a commercial in Japan, where there are no unions, no featherbedding, no worthless stooges hanging on.

Just imagine scheduling a commercial to be shot at 7:30 a.m. and actually having the camera roll by 7:45 a.m. Imagine traveling seven and one-half hours on a rickety bus to shoot a commercial in a Japanese ski lodge with 22 members of a Japanese crew and never hearing one sound of complaint.

Mr. Della Femina is president of the advertising agency of Della Femina, Travisano and Partners, Inc., of New York City. He is the author of the current best-selling From Those Wonderful Folks Who Gave You Pearl Harbor.

Imagine finishing the last day's screening and handing each and every member of the crew a gift because you know you'll probably never work with anyone as good as they were again.

Compare it with shooting a commercial in the United States. Where a typical shooting is a disgrace... where you have a producer, director, cameraman, sound technician, and a few others working their butts off and a lot of other guys standing around doing nothing.

Compare it with the American commercial that you schedule at 9 a.m. and get your first shot in just before everybody breaks for lunch. Where you have five or six union guys sitting around who do nothing but jack up the cost.

There's always one guy who invariably falls sound asleep before the second take and doesn't wake up until it's a wrap. He gets paid for a full day's work. Then there's one guy who sits around and reads the *Daily News*.

And another guy who tries to make the script girl, the wardrobe mistress, the fashion stylist and any other woman who happens to be on the set. And let's not forget the guy who just sits and stares into space. And finally there's the guy who spends most of the time angling to steal product, props or anything else that isn't tied down.

I complimented a Japanese businessman on the attitude and ability of the television film crews in his country. He replied that the Japanese in every field of business consider it an honor, and a pleasure, to work for a living. Then, with a bit of Japanese humor he looked at me and said, "Once it was the same in the United States, wasn't it?" "Yes," I replied, "it was." It isn't anymore.

